



THE CITY OF SAN DIEGO
MAYOR JERRY SANDERS

M E M O R A N D U M

DATE: April 3, 2008

TO: Councilmember Donna Frye

FROM: Greg Levin, Comptroller

SUBJECT: Response to memo from Councilmember Donna Frye titled "*Changes to the City of San Diego's 2005 Summary of Net Assets in the 2006 Comprehensive Annual Financial Report (CAFR)*"

This memorandum serves as the response to the attached memorandum entitled "*Changes to the City of San Diego's 2005 Summary of Net Assets in the 2006 Comprehensive Annual Financial Report (CAFR)*", dated April 1, 2008.

Background:

In your memorandum you requested a response to why the City's *Governmental Activities* Net Assets for FY 2005 are reclassified in the FY 2006 CAFR on page 36 of the Management's Discussion and Analysis. You also noted that the same Net Assets were reclassified for the *Total Primary Government* column; that reclassification is simply the result of the Governmental Activities reclassification. This memo will address the six (6) questions.

QUESTIONS 1 & 2:

Why were these numbers changed?
Which numbers are correct?

ANSWER 1 & 2:

The City is committed to continuously improving the City's financial statements. In this regard, the classification of each revenue, expense and equity/net asset balance is reviewed with the issuance of every CAFR. The review performed during the completion of the FY 2006 CAFR resulted in a different classification of the restrictions, both internal and external, for certain governmental activities debt, and housing reserves. The conclusion was that a significant amount of the outstanding bonds within the Redevelopment Agency accounts are for the purchase of assets that are inherently governmental (infrastructure and other general government

capital assets). Therefore, the related debt balances were reclassified as a component of invested in capital assets, net of related debt for governmental activities.

The external auditors agreed with management's position, and in order to comply with accounting standards the City needed to reclassify the Net Asset components for FY 2005 on page 36 in order to provide the users of the statements with comparable data.

According to accounting standards, it is necessary that prior-year figures shown for comparative purposes be comparable with those shown for the current period. Standards also require that reclassifications or other changes affecting comparability of financial statements presented should be disclosed (*Accounting Research Bulletin (ARB) – 43 Chapter 2*). The example given for proper disclosure of reclassifications which have **no effect on previously reported net income** is as follows:

Example 16-1: Reclassifications of a General Nature

“Certain amounts in the prior periods presented have been reclassified to conform to current period financial statement presentation.”

The MD&A is the only section within the CAFR which requires comparative schedules. Therefore, in keeping with FASB ARB No. 43 we reclassified the Governmental Activities Net Assets to conform to current year presentation, and we included the required footnote disclosures on page 36, under the comparison table, as well as page 75, Note 1 “Summary of Significant Accounting Policies.”

It is management's opinion that both presentations are acceptable. The presentation of accounts in the financial statements is occasionally subject to professional judgment and changes in presentation do not necessarily result in one number being incorrect or vice versa. In fact, changes in presentation can be the result of changes in the City's operations or organizational structure. Again, this reclassification had no effect on previously reported net income.

QUESTION 3:

Are these changes material?

ANSWER 3:

These reclassifications have no impact on net income or total net assets and are, in the opinion of management and the external auditors, properly disclosed and as such are not material.

QUESTION 4:

Do you believe that this information should have been pointed out to the City Council on March 25, 2008 when this specific item was being discussed?

To: Councilmember Donna Frye

Date: March 19, 2008

ANSWER 4:

As mentioned previously, neither management nor the external auditors find this reclassification a significant or material change. The change was not made to have unrestricted net assets look better or worse, it was made to ensure that the presentation and reporting of the City's financial statements reflected the nature of the funds being reported. Reclassification of accounts to reflect the changing nature of the City's operations is common practice and management does not view the change as significant.

QUESTION 5:

What other numbers shown in the 2005 CAFR (for 2005) have been changed in the 2006 CAFR for 2005?

ANSWER:

None.

QUESTION 6:

Please provide a list of land and properties that are currently included in the restricted net assets including the reason(s) for the restrictions.

ANSWER 6:

Land and properties are not reported as a component of restricted net assets. All capital assets, which includes land and properties, is reported as the primary component of invested in capital assets, net of related debt.

Attachments:

1. Memorandum from Councilmember Donna Frye

cc: Honorable Mayor Jerry Sanders
Honorable Members of the City Council
Jay M. Goldstone, COO
Mary Lewis, CFO
Andrea Tevlin, IBA
Michael Aguirre, City Attorney



COUNCILMEMBER DONNA FRYE

City of San Diego
Sixth District

MEMORANDUM

08-13

DATE: April 1, 2008

TO: Macias, Gini & O'Connell
Jay Goldstone, COO
Greg Levin, City Comptroller

FROM: Councilmember Donna Frye

Donna Frye

SUBJECT: Changes to the City of San Diego's 2005 Summary of Net Assets in the 2006 Comprehensive Annual Financial Report (CAFR)

On March 21, 2008, Macias, Gini & O'Connell (MGO), issued their Independent Auditor's Report for the City of San Diego's 2006 CAFR.

On March 23, 2008, the Mayor released the City's 2006 CAFR with MGO's report.

On March 25, 2008, the City Council reviewed the City of San Diego's 2005 CAFR. There was a discussion and a variety of questions raised about the City of San Diego's Summary of Net Assets (both the numbers shown in the table and the narrative that directly followed the table) shown on page 38 (attached). The City Council voted to receive and file the 2005 CAFR, with my voting in opposition for a variety of reasons disclosed during that meeting.

On page 36 of the City's 2006 CAFR (attached), there is a footnote to the City of San Diego's Summary of Net Assets table that states, "*Certain amounts have been reclassified to conform to current year presentation.*"

Upon first review, I noticed that three of the four amounts shown for 2005 Net Assets for *Governmental Activities* are different in the 2006 CAFR than what was shown in the 2005 CAFR, and three of the four amounts shown for 2005 Net Assets for *Total Primary Government* are different in the 2006 CAFR than the 2005 CAFR.

For example, the 2005 CAFR for *Total Primary Government* shows approximately \$279 million in total Net Assets that “*represent resources that are subject to external restrictions on how they may be used*” and approximately \$56 million in total Net Assets that is unrestricted and “*available to finance ongoing services and obligations to the City’s citizens and creditors.*”

In the 2006 CAFR, the amount shown for 2005 restricted Net Assets is approximately \$434 million and the amount shown for 2005 unrestricted net assets is approximately \$23 million.

Specifically, restricted Net Assets increased from \$279,237 million to \$434,415 (approximately \$155 million), and unrestricted Net Assets decreased from \$56,224 million to \$23,266 million (approximately \$33 million)

Please address the following questions:

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1. Why were these numbers changed?
 2. Which numbers are correct?
 3. Are these changes material?
 4. Do you believe that this information should have been pointed out to the City Council on March 25, 2008 when this specific item was being discussed? If yes, why wasn't it? If no, why not?
 5. What other numbers shown in the 2005 CAFR (for 2005) have been changed in the 2006 CAFR for 2005?
 6. Please provide a list of land and properties that are currently included in the restricted net assets including the reason(s) for the restrictions.

I am requesting a written response to my questions within 30 days. Thank you.

CC: Councilmember Kevin Faulconer, Chair, Audit Committee
Honorable City Councilmembers
Honorable Mayor Jerry Sanders
Andrea Tevlin, Independent Budget Analyst
Michael Aguirre, City Attorney
Stanley Keller, Independent Monitor

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GOVERNMENT-WIDE FINANCIAL ANALYSIS

CITY OF SAN DIEGO'S SUMMARY OF NET ASSETS
(In Thousands)

| | Governmental Activities | | Business-Type Activities | | Total Primary Government | |
|-----------------------------|-------------------------|--------------|--------------------------|--------------|--------------------------|--------------|
| | 2006 | 2005* | 2006 | 2005 | 2006 | 2005* |
| Capital Assets | \$ 4,307,640 | \$ 4,284,409 | \$ 4,536,313 | \$ 4,507,385 | \$ 8,843,953 | \$ 8,791,794 |
| Other Assets | 1,511,124 | 1,337,369 | 650,350 | 647,459 | 2,161,474 | 1,984,828 |
| Total Assets | 5,818,764 | 5,621,778 | 5,186,663 | 5,154,844 | 11,005,427 | 10,776,622 |
| Net Long-Term Liabilities | 1,876,763 | 1,797,521 | 1,866,411 | 1,870,766 | 3,743,174 | 3,668,287 |
| Other Liabilities | 160,423 | 192,679 | 109,123 | 116,070 | 269,546 | 308,749 |
| Total Liabilities | 2,037,186 | 1,990,200 | 1,975,534 | 1,986,836 | 4,012,720 | 3,977,036 |
| Net Assets: | | | | | | |
| Invested in Capital Assets: | | | | | | |
| Net of Related Debt | 3,472,531 | 3,478,769 | 2,867,469 | 2,863,136 | 6,340,000 | 6,341,905 |
| Restricted | 449,173 | 401,486 | 35,085 | 32,929 | 484,258 | 434,415 |
| Unrestricted | (140,126) | (248,677) | 308,575 | 271,943 | 168,449 | 23,266 |
| Total Net Assets | \$ 3,781,578 | \$ 3,631,578 | \$ 3,211,129 | \$ 3,168,008 | \$ 6,992,707 | \$ 6,799,586 |

* Certain amounts have been reclassified to conform to current year presentation

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$6,992,707 at June 30, 2006, an increase of \$193,121 over fiscal year 2005.

\$6,340,000, or approximately 91%, of total Net Assets represent the City's investment in capital assets (e.g., land, structures and improvements, equipment, distribution and collections systems, infrastructure, and construction-in-progress), less any outstanding debt used to acquire these assets. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves generally are not used to liquidate these liabilities.

\$484,258, or approximately 7%, of total Net Assets represent resources that are subject to external restrictions on how they may be used. The remaining balance of \$168,449, or approximately 2%, is available to finance ongoing services and obligations to the City's citizens and creditors.

Unrestricted Net Assets increased by \$145,183, primarily due to: a decrease of approximately \$46,000 in the amount of outstanding debt for governmental activities which is not capital or housing related; an increase in revenue accruals of approximately \$30,000 for In-Lieu Vehicle License Fees and grants receivable of governmental activities; an increase of \$23,000 in capital contributions related to land acquisition credits of the governmental activities; a decrease in liability claim accruals of approximately \$21,000 resulting from claims settled in fiscal year 2005 and fiscal year 2006 and a slightly lower actuarial valuation for public liability claims; and an increase in sales of water of approximately \$12,000 in the Water Utility due to rate increases.

The deficit balance of (\$140,126) in Unrestricted Net Assets for Governmental Activities reflects the fact that governmental activities raise resources based on when liabilities are expected to be paid, rather than when they are incurred. Most governments normally do not have sufficient current resources on hand to cover current and long-term liabilities. This deficit in and of itself should not be considered an economic or financial difficulty; however, it does measure how far the City has committed the government's future taxing power for purposes other than capital acquisition.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

CITY OF SAN DIEGO'S SUMMARY OF NET ASSETS
(In Thousands)

| | Governmental Activities | | Business-Type Activities | | Total Primary Government | |
|------------------------------------|-------------------------|--------------|--------------------------|--------------|--------------------------|--------------|
| | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 |
| Capital Assets | \$ 4,284,409 | \$ 4,146,158 | \$ 4,507,385 | \$ 4,417,208 | \$ 8,791,794 | \$ 8,563,366 |
| Other Assets | 1,337,369 | 1,231,985 | 647,459 | 773,434 | 1,984,828 | 2,005,419 |
| Total Assets | 5,621,778 | 5,378,143 | 5,154,844 | 5,190,642 | 10,776,622 | 10,568,785 |
| Net Long-Term Liabilities | 1,797,521 | 1,676,681 | 1,870,766 | 1,901,897 | 3,668,287 | 3,578,578 |
| Other Liabilities | 192,679 | 156,271 | 116,070 | 122,288 | 308,749 | 278,559 |
| Total Liabilities | 1,990,200 | 1,832,952 | 1,986,836 | 2,024,185 | 3,977,036 | 3,857,137 |
| Net Assets: | | | | | | |
| Invested in Capital Assets, Net of | | | | | | |
| Related Debt | 3,600,989 | 3,200,262 | 2,863,136 | 2,818,690 | 6,464,125 | 6,018,952 |
| Restricted | 246,308 | 491,722 | 32,929 | 30,409 | 279,237 | 522,131 |
| Unrestricted | (215,719) | (146,793) | 271,943 | 317,358 | 56,224 | 170,565 |
| Total Net Assets | \$ 3,631,578 | \$ 3,545,191 | \$ 3,168,008 | \$ 3,166,457 | \$ 6,799,586 | \$ 6,711,648 |

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$6,799,586 at June 30, 2005, an increase of \$87,938 over fiscal year 2004.

\$6,464,125, or approximately 95%, of total Net Assets represent the City's investment in capital assets (e.g., land, structures and improvements, equipment, distribution and collections systems, infrastructure, and construction-in-progress), less any outstanding debt used to acquire these assets. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves generally are not used to liquidate these liabilities.

\$279,237, or approximately 4%, of total Net Assets represent resources that are subject to external restrictions on how they may be used. The remaining balance of \$56,224, or approximately 1%, is available to finance ongoing services and obligations to the City's citizens and creditors.

Unrestricted Net Assets decreased by \$114,341, or approximately 67%, primarily due to an increase in the Net Pension Obligation (approximately \$58,000) as well as resources being utilized in the acquisition and construction of capital assets.

The deficit balance of (\$215,719) in Governmental Activities Unrestricted Net Assets reflects the fact that governmental activities raise resources based on when liabilities are expected to be paid, rather than when they are incurred. Most governments normally do not have sufficient current resources on hand to cover current and long-term liabilities. This deficit in and of itself should not be considered an economic or financial difficulty; however, it does measure how far the City has committed the government's future taxing power for purposes other than capital acquisition.